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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1932

No. 95

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

COMMONWEALTH IMPROVEMENT COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED MAY 20, 1933

CERTIORARI GRANTED MAY 31, 1933

SUPREME COURT OF THE UNITED STATES

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Before United States Board of Tax Appeals

Docket No. 24959

COMMONWEALTH IMPROVEMENT COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For petitioner, E. A. Ballard, Esq., Wm. R. Spofford, Esq., Schofield Andrews, Esq.; for respondent, John D. Foley, Esq.

Docket entries

Mar. 7, 1927. Petition received and filed. Taxpayer notified.
Mar. 8, 1927. Copy of petition served on general counsel.
May 7, 1927. Motion for extension to 7/7/27 to file answer filed by general counsel.
May 10, 1927. Granted. Both sides notified.
July 7, 1927. Answer filed by general counsel.
July 8, 1927. Copy of answer served on taxpayer—General Calendar.
Apr. 23, 1929. Hearing set 6/19/29.
2 June 19, 1929. Hearing had before Logan Morris, Division 14, on merits. Petitioner's motion to continue to October granted.
June 19, 1929. Order placing on General Calendar for hearing fall term, 1929, entered.
Aug. 5, 1929. Hearing set 10/8/29.
Oct. 8, 1929. Hearing held before Percy W. Phillips, Division 11, on the merits. Briefs due in 60 days.
Oct. 21, 1929. Transcript of hearing 10/8/29 filed.
Dec. 6, 1929. Brief filed by taxpayer.
Dec. 7, 1929. Brief filed by general counsel.
Oct. 9, 1930. Findings of fact and opinion rendered, P. W. Phillips, Division 11. Decision will be entered for respondent.
Oct. 9, 1930. Decision entered, Percy W. Phillips, Division 11.
Apr. 6, 1931. Petition for review by U. S. Circuit Court of Appeals (3), with assignments of error filed by taxpayer.
Apr. 6, 1931. Proof of service filed.
May 6, 1931. Statement of evidence lodged.
May 6, 1931. Præcipe filed.
May 6, 1931. Proof of service of præcipe and statement of evidence with hearing notice 5/20/31 filed.
May 19, 1931. Statement of evidence approved and ordered filed.

3 Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed March 7, 1927

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:E:SM–60D–AJL–C–30211), dated January 13, 1927, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation organized and existing under the laws of Pennsylvania, with its principal office at 405 Land Title Building, Philadelphia, Pennsylvania.

2. The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on January 13, 1927.

3. The taxes in controversy are income and profits taxes for the calendar year 1920 and are for $294,388.42.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

4 (a) The respondent has increased petitioner's net income by $1,055,953.12, alleged profit upon the transfer in 1920 of 225,000 shares of British-American Tobacco stock by the petitioner to its sole stockholder, the estate of P. A. B. Widener, deceased.

5. The facts upon which the petitioner relies as the basis of this proceeding are:

(a) During 1920, and for many years prior thereto, all of petitioner's capital stock was owned by the estate of P. A. B. Widener. At the time of the transfer of British-American shares above referred to the said estate also owned all of petitioner's outstanding bonds ($4,000,000 face value) and had a book claim against petitioner of $250,417.78 on open account.

(b) During 1920 the trustees of the estate of P. A. B. Widener were Joseph E. Widener and George D. Widener, and they, with Ellis Ames Ballard, counsel for the estate, were also directors and officers of the petitioner, being, respectively, president, vice president, and secretary treasurer.

(c) On March 18, 1920, the trustees caused the petitioner to transfer to the estate 225,000 shares of British-American Tobacco Company stock having a market value at that time of 23½ per share, or $5,287,500. In order to balance the books of the estate and the petitioner, the trustees then caused the estate to surrender all of petitioner's bonds ($4,000,000) face value to cancel its open account of $250,417.78 to transfer to the petitioner sundry stocks having a value of $299,287.78 and to settle the balance of $737,794.44 by book credit in favor of petitioner.

5 (d) The 225,000 shares of British-American Tobacco Company stock were acquired by the petitioner from the late P. A. B. Widener in 1912 at a book cost of $3,966,002, the petitioner having

then issued its securities to Mr. Widener in payment therefor. The value on March 1, 1913 (which is not disputed by the respondent) was $5,315,625, or $23⅝ per share. In 1919 the petitioner acquired the right to subscribe to new shares to the extent of one-third of its holdings. This right was exercised by the payment of $326,437.50. In accordance with the regulations of respondent then in effect, the petitioner was not required and therefore did not attempt to find a quotient value for each share by averaging the sum of the March 1, 1913, value plus the subscription price paid in 1919, but applied the March 1, 1913, value, $5,315,625 (being, as aforesaid, the value of the 225,000 shares first acquired) against the transfer price of $5,287,500 which resulted in a book loss of $28,125.

(e) Subsequent to the filing of the 1920 income and profits tax return and the payment of the tax shown to be due thereon, Treasury Decision 3402 (approved October 18, 1922) was issued. The application of the averaging method contained in this decision and the resulting quotient figure reduce the basis of the 225,000 shares of British-American Tobacco Company stock to $4,231,546.88, upon which the respondent has computed a taxable profit of $1,055,953.12.

Wherefore, the petitioner prays that this board may hear the proceeding and determine that no part of the bookkeeping profit of $1,055,953.12 realized in the transfer of 225,000 shares of
6 British-American Tobacco Company stock constitutes taxable income to the petitioner.

(Sgd.) WM. R. SPOFFORD,
Counsel for Petitioner,
1035 Land Title Bldg., Philadelphia, Pa.

[*Duly sworn to by Ellis A. Ballard; jurat omitted in printing.*]

7 *Exhibit A to petition*

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, Jan. 13, 1927.

IT:E:SM–60D
AJL–C30211

COMMONWEALTH IMPROVEMENT CO.,
405 Land Title Bldg., Philadelphia, Pa.

SIRS: An audit of your income and excess-profits tax return for the calendar year 1920 has resulted in the determination of a deficiency in tax of $294,388.42, as shown in the attached statement.

In accordance with the provisions of section 274 of the revenue act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals, and has not done so within the 60 days prescribed, and an assessment has been made or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the collector of internal revenue. No claim for abatement can be entertained.

8 If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:E:SM–60D, AJL–C–30211. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
Commissioner.

(Signed) C. R. NASH,
Assistant to the Commissioner.

Inclosures:
Statement.
Form A.
hlc–l.

9 STATEMENT

JAN. 13, 1927.

In re: Commonwealth Improvement Co., 405 Land Title Bldg., Philadelphia, Pa.

1920—Deficiency in tax, $294,388.42

Reference is made to your protests dated Sept. 28, 1926, and Oct 22, 1926, against adjustments made by the bureau relating to the following items in the determination of your net income for the year 1920, as set forth in bureau letter dated Sept. 24, 1926:

(a) Dividends received from foreign corporations	$234,779.55
(b) Profit on sale of British-American Tobacco Co. Stock	$1,055,953.12

After careful review of your protest and of all the evidence submitted in support of your contentions, you are advised that the bureau holds as follows relative to the protested items.

The protest of September 28, took exception to Item 4, "Dividends received from foreign corporations, $234,779.55." This issue has now been allowed as noted below.

The protest of October 22, 1926, raises the same contention in respect to the above dividends, also takes exception to item 2, "Profit on sale of British-American Tobacco Company stock, $1,055,953.12." This item was considered in previous conferences held in this office under dates of January 20, 1925 and February 14, 1925, at which time you were requested to submit additional information. The data submitted in your brief of October 22, 1926, is held to be inadequate to allow your contention.

The Unit holds the following computation as indicating the profit to be reported as income:

10 You purchased 225,000 shares of stock for $3,966,002.00 prior to March 1, 1913. The March 1, 1913, value was $5,315,625.00. In 1919 you received the right to subscribe to one share for each three shares held. 75,000 shares were purchased at $4.3525, or a total of $326,437.50. You transferred 225,000 shares to the Widener estate at market 23½, or $5,287,500.00. In the 1920 return filed you show selling price of $5,287,500.00 against which is applied $5,315,625.00 (225,000 shares at 23⅝ths. This is the March 1, 1913, value of shares based on 1913 quotations, but does not take into consideration the shares subscribed for under "rights."

Treasury Decision 3402, approved October 18, 1922, amended the basis of computing cost of stock sold when a part of the stock was acquired under subscription rights. The March 1, 1913, value of 225,000 shares was $5,315,625 to which was added 75,000 shares costing $326,437.50. This resulted in 300,000 shares at $5,642,062.50. The quotient cost under Treasury Decision 3402 is 18.806875 instead of 23⅝ths. This results in a profit of $1,055,953.12 instead of the loss claim by you. The selling price at market at 23½ for the 225,000 shares was made up by the purchaser by a cancellation of the $4,000,000.00 in bonds, the transfer of securities belonging to the estate, together with the obligation to pay the balance in cash.

Recomputation of your tax liability under Section 328 results in an amended deficiency in tax of $294,388.42 determined as follows:

ADJUSTMENTS TO NET INCOME

Net loss reported on return		$62,283.59
Add:		
(1) Profit on sale of scrip	$28,500.00	
(2) Profit on sale of British-American Tobacco Co. stock	1,055,953.12	
11 (3) Loss reported on same	28,125.00	
(4) Dividends received from foreign corporations	101,292.26	
		1,213,870.38
Total additions		$1,151,586.79
Less:		
(5) Refund, 1918	1,709.21	
(6) Taxes allowed	8,290.79	
		$10,000.00
Adjusted net income		$1,141,586.79

EXPLANATION OF ADJUSTMENTS TO NET INCOME

(1) To reflect profit on sale of scrip. This scrip was received in 1919 at a face value of $30,000.00, and was sold during 1920 for $58,500.00. The gain is held to be income for 1920.

(2) Profit on sale of British-American Tobacco stock in accordance with Treasury Decision 3402, which reads in part as follows:

"Whereas the stockholder exercises his right to subscribe to new stock of substantially the same character or preference as the stock with respect to which the right is issued, the cost of the old and new shares (or if acquired prior to March 1, 1913, the fair market value as of that date) will be the quotient cost of the old shares plus the subscription price of the new shares, divided by the total number of the old and new shares."

225,000 shares at March 1, 1913, value (23⅝)		$5,315,625.00
75,000 shares acquired through right to subscribe in 1919, 4.34¼		326,437.50
300,000		$5,642,062.50
12	Quotient cost per share	18.806875
	225,000 shares sold for 23½	$5,287,500.00
225,000 shares cost at 18.806875		4,231,546.88
	Profit	$1,055,953.12

(3) To adjust for loss on this item deducted on the return.

(4) To restore to income the dividends received from foreign corporations. The records of this office disclose that a return was filed by the Imperial Tobacco Company for each of the years 1918, 1919, and 1920, but the taxes paid for 1920 were refunded, as it was held that no taxable income was received during 1920 from sources within the United States. The dividends, therefore, received from this corporation are held to be taxable income. Since the returns of the British-American Tobacco Company and the Anglo-American Oil Company disclose that these corporations received income subject to tax from sources within the United States, dividends received from these corporations are not subject to tax.

(5) To adjust for refund for 1918 which was credited to taxes paid instead of to surplus.

(6) To adjust for taxes charges to surplus on books, which were allowed as deductions by agent. The contention relative to the stock dividend of Garland Stock in the amount of $22,500.00 is conceded and this item is omitted from income in this audit.

COMPUTATION OF TAX

Profits tax, section 328			$282,824.96
Net income		$1,141,586.79	
Less:			
13 Profits tax	$282,824.96		
Exemption	2,000.00		
		$284,824.96	
Amount taxable at 10%		856,761.83	$85,676.18
Correct tax liability			368,501.14
Credit for taxes paid to Great Britain			74,112.72
Total tax assessable			294,388.42
Previously assessed			None.
Deficiency in tax			294,388.42

Inasmuch as a hearing has already been held in the bureau in the matter of the profit on sale of British-American Tobacco Company stock, $1,055,953.12, and all information submitted in connection therewith carefully considered, your request for another conference can not be granted.

A copy of this letter is being forwarded to your authorized representative, Mr. Schofield Andrews, of Ballard, Spahr, Andrews and Madeira, 1035 Land Title Building, Philadelphia, Pennsylvania.

hlc-l

14 Before U. S. Board of Tax Appeals

Answer

Filed July 7, 1927

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, general counsel, Bureau of Internal Revenue, for answer to the petition heretofore filed by the above-named petitioner, admits and denies as follows:

1. Admits the allegations of paragraph numbered 1.
2. Admits the allegations of paragraph numbered 2.
3. Admits the allegations of paragraph numbered 3.

5(a). Admits the allegations of subparagraph (a) of paragraph 5.

(b) For lack of information upon which to base a belief, he denies the allegations of subparagraph (b) of paragraph 5.

(c) Answering the allegations of subparagraph (c) of paragraph 5, he admits that the petitioner transferred to the estate of P. A. B. Widener on March 18, 1920, 225,000 shares of British-American Tobacco Company stock having a market value at the time of $23.50 a share, or $5,287,500. Admits that the trustees of the estate of P. A. B. Widener surrendered to the petitioner its bonds of a face value of $4,000,000, that they cancelled an open account due from petitioner to said estate in the amount of $250,417.78, that they trans-

ferred to petitioner sundry stocks having a value of $299,287.78,
15 and that the balance was settled by a book credit of $737,-794.44 in favor of petitioner. Denies the remaining allegations of subparagraph (c) of paragraph 5.

(d) Answering the allegations of subparagraph (d) of paragraph 5, he admits that 225,000 shares of British-American Tobacco Company stock were acquired by petitioner from the late P. A. B. Widener in 1912, but is not advised of the book cost of said stock, and therefore denies that it was $3,966,002 or any amount. Admits that the value of this stock on March 1, 1913, was $5,315,625, or $23⅝ a share. Admits that in 1919 petitioner acquired the right to subscribe for new shares to the extent of one-third of its holdings. Admits that this right was exercised by the payment of $326,437.50. Denies the remaining allegations of subparagraph (d) of paragraph 5.

(e) Admits the allegations of subparagraphs (e) of paragraph 5.

Denies generally and specifically each and every allegation not hereinbefore admitted, qualified, or denied.

Wherefore it is prayed that said petition be denied.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

Of counsel:

JOHN D. FOLEY,
Special Attorney, Bureau of Internal Revenue.

16 Before U. S. Board of Tax Appeals

Findings of fact and opinion

Promulgated October 8, 1930

1. The original cost of stock, with respect to which stock rights have been received and exercised, must be adjusted to give effect to the acquisition of the new stock in determining the basis for computing gain or loss upon the sale of a portion of such stock. Miles v. Safe Deposit Co., 259 U. S. 247, and Frederick Ayer, 6 B. T. A. 152; affd., 25 Fed. (2d) 534, followed.

2. The sale of securities by a corporation to its sole stockholder at a price in excess of cost and March 1, 1913, value results in taxable gain.

Ellis Ames Ballard, Esq., William R. Spofford, Esq., and Schofield Andrews, Esq., for the petitioner.

John D. Foley, Esq., for the respondent.

Respondent has determined a deficiency against petitioner of income and profits taxes for the calendar year 1920 in the amount of $294,388.42. The error alleged is that respondent has increased petitioner's net income by $1,055,953.12, alleged profit from the trans-

fer in 1920 of 225,000 shares of British-American Tobacco stock by petitioner to its sole stockholder, the estate of P. A. B. Widener, deceased.

Findings of fact

Petitioner is a corporation organized and existing under the laws of Pennsylvania, with its principal office at 405 Land Title Building, Philadelphia, Pennsylvania.

In 1911 P. A. B. Widener was a large stockholder in the Standard Oil Company and the American Tobacco Company. In 1911 these companies were dissolved pursuant to a decree of the Supreme
17 Court of the United States. Under this dissolution there came into the hands of P. A. B. Widener stock of companies incorporated in many of the different States and in Great Britain and having a value of about $20,000,000. P. A. B. Widener was then about eighty years of age and his affairs were attended to by his son, George D. Widener. Counsel for P. A. B. Widener advised George D. Widener that death duties upon his father's estate could be avoided to a certain extent by putting all of his securities, other than those of Pennsylvania corporations, into a Pennsylvania corporation. Upon being approached on the subject P. A. B. Widener rejected the plan.

George D. Widener was lost on the "Titanic" on April 12, 1912. In the meantime P. A. B. Widener had purchased at a cost of some $3,000,000 to $4,000,000 a large tract of land in Philadelphia and built thereon the Widener Memorial School for Crippled Children, hereafter referred to as the Charity. After the death of George D. Widener, P. A. B. Widener sent for his counsel and stated that he then had no one to advise him and that he was anxious to create a safe endowment for the Charity. He stated to counsel that he desired the endowment to be $4,000,000 and that he might raise it to $5,000,000, and he desired to place a lien upon his whole fortune to secure the endowment. Counsel advised Widener that under the laws of Pennsylvania this plan was not feasible, but that Widener might transfer to petitioner all of his non-Pennsylvania securities, and against these securities have petitioner issue debentures which would serve the purpose of the endowment. Widener told counsel to proceed accordingly. All of Widener's non-Pennsylvania securities, except one share of United States Steel, which was reserved in order to qualify Widener as a director in that corporation, were transferred as of May 1, 1912, to petitioner in consideration
18 of $5,000,000 of capital stock, $5,000,000 of script convertible into capital stock at the option of petitioner, first 4 per cent debentures in the amount of $5,000,000, and 6 per cent debentures in the amount of $10,000,000. The whole issue of stocks and bonds aggregating $25,000,000 par value thus became the property of Widener. Subsequently, in 1912, a deed of trust was executed and

$4,000,000 of the $5,000,000 first 4 per cent debentures were delivered to the Land Title and Trust Company of Philadelphia to hold the same in perpetuity as an endowment for the Charity.

P. A. B. Widener died testate in the year 1915. After making certain devises and legacies, practically the whole of the estate of Widener was by his will left in a long term trust. The Charity was not mentioned in the will and received nothing thereunder. The estate of Widener consisted of securities of Pennsylvania corporations, including the stock in petitioner; some real estate; his qualifying share in the United States Steel Corporation; and his collection of pictures, which eventually will go to the city of Philadelphia. All his interest in non-Pennsylvania corporations had, as above set forth, been conveyed to petitioner and was at the date of his death owned by it. No death taxes were paid to any of the States other than Pennsylvania upon the non-Pennsylvania stocks or securities by reason of the death of P. A. B. Widener.

The executors and trustees under the will of Widener were his surviving son, Joseph E. Widener, and his grandson, George D. Widener, son of testator's deceased son, George D. Widener. The directors and officers of petitioner were said Joseph E. Widener, said George D. Widener, grandson of P. A. B. Widener, and one Ballard. Ballard has been secretary and treasurer of petitioner since May 1, 1912, was counsel for P. A. B. Widener until his death and later for his estate. Ballard has received no compensation as coun-
19 sel for the estate, but he receives annually from petitioner the sum of $20,000, which covers both his services as secretary and treasurer of petitioner and also his services as counsel for the estate. The trustees have not received commissions from the estate, but each has been paid annually the sum of $25,000 as salary as an officer of petitioner. In 1920 and for many years prior thereto the clerks and bookkeepers of the estate and the office expenses were paid by petitioner. At times when petitioner or the estate was in need of funds or either desired stock to hypothecate, and it seemed more desirable that the transaction should be in the one name or the other, transfers would be made and proper entries made on the books of both.

Two years after the death of P. A. B. Widener petitioner's capital structure was reduced to $2,000,000 capital stock and $4,000,000 of debentures, being the same debentures deposited with the trustee for the Charity. The issues of $10,000,000 6 per cent debentures, $1,000,000 of the 4 per cent debentures, $3,000,000 of stock, and $5,000,000 of script was cancelled and cremated. This was accomplished by transferring from petitioner to the trustees of the estate securities of value equal to the securities cancelled, and if there was a difference in value it was entered on the books of each as a credit or debit, as the case might be.

The trustees of the estate of Widener continued to hold all petitioner's stock except the qualifying shares of the directors, which

were in fact owned by the estate. The trustee for the Charity held the $4,000,000 debentures until 1920. In that year the trustees of the estate desired to substitute for these debentures certain real estate bonds on properties owned by the estate of Widener. To this the trustee for the Charity consented, and the substitution was made. In this way the estate of Widener became the owner of $4,000,000 of debentures, which constituted a claim in favor of the estate against the petitioner.

20 In 1920 the trustees of the estate transferred to petitioner these debenture bonds of the value of $4,000,000 and sundry stocks of a value of $299,287.78, cancelled an open account due said estate from petitioner of $250,417.78, and credited petitioner on its books with $737,794.44. In exchange therefor petitioner transferred to the estate 225,000 shares of stock of the British-American Tobacco Company of a market value of $23.50 per share, or a total value of $5,287,500, and charged the estate with the balance of $737.794.44. Two hundred and twenty-five thousand shares of the British-American Tobacco Company stock were acquired by petitioner from P. A. B. Widener in 1912 at a cost of $3,966,002. The value of said shares on March 1, 1913, was $5,315,625, or $23.625 per share. In 1919 petitioner acquired the right to subscribe for new shares of the British-American Tobacco Company to the extent of one-third of its holdings, and exercised this right by the payment of $326,437.50, increasing its holdings to 300,000 shares and making the average cost $18.806875 per share, and upon this basis respondent has computed the gain on the transfer above set forth. The certificates transferred were those which evidenced the original holding of 225,000 shares.

Joseph Widener, who was the president of petitioner and one of the trustees of the estate, told Ballard that he desired to make the substitution of securities in the Charity's endowment above set forth. Ballard, as secretary and treasurer, arranged the transaction and wrote it up on the minutes, which were approved by the other directors. Every year Ballard received proxies from the stockholders of record. He held the meetings in his office and wrote up the minutes. There never has been a meeting of the stockholders or directors in which the stockholders and directors sat around a table and made motion or passed resolutions. The consultations between officers and stockholders have been informal.

21 *Opinion*

PHILLIPS:

Petitioner makes the following contentions: (1) That it and the estate of P. A. B. Widener (hereafter referred to as the estate) are one and the same entity and neither gain nor loss can result from transactions between them, and (2) that the March 1, 1913, value as

a basis for determining gain or loss upon the stock sold by petitioner should not be affected or decreased by the exercise of stock rights at a subsequent date.

While the petitioner does not present any argument upon the second point, some explanation is necessary to understand the manner in which the controversy arises. In 1911 or 1912 petitioner acquired 225,000 shares of the stock of British-American Tobacco Company at a cost of $3,966,002. On March 1, 1913, these shares had a value of $5,315,625. In 1919 the petitioner received stock rights which it exercised, acquiring 75.000 additional shares at a cost of $326,437.50. In 1920 it sold 225,000 shares to the estate for $5,287,500, which was their market value on the date of sale. Upon its income-tax return petitioner claimed a loss of the difference between the selling price and a March 1, 1913, value of $5,315,625. The commissioner made the following adjustment in the cost or March 1, 1913, value:

225,000 shares; March 1, 1913, value	$5, 315, 625. 00
75,000 shares; acquired on exercise of stock rights for	326, 437. 50
300,000 shares	$5, 642, 062. 50
1 share	18. 806875
225,000 shares	$4, 231, 566. 88

22 The application of the averaging method of computing the cost basis for determining gain or loss on the sale of stocks with respect to which there have been stock dividends or subscription rights has been approved by the courts and this board in Miles v. Safe Deposit Company, 259 U. S. 247, and Frederick Ayer, 6 B. T. A. 152, affirmed, 25 Fed. (2d) 534. By reason of the application of this principle the commissioner has determined that there was a profit to petitioner of $1,055,953.12 on the sale of this stock instead of a loss of $28,125 as claimed by petitioner upon its return. The petitioner does not now argue before the board that the method of computing the gain was incorrect, but relies entirely upon its contention that the corporation and the estate are the same entity. If this contention were logically applied it would follow that all income received by the corporation since its organization was properly taxable as income of P. A. B. Widener and his estate and should have been added to any other income which Widener and his estate received during these years and taxed at the rates applicable to individuals rather than returned by the petitioner and taxed at the rates fixed for corporations. For the purposes of inheritance and transfer taxes imposed by the various States upon the transfer of the stocks owned by petitioner the corporate entity should have been disregarded upon the death of Widener and these stocks subjected to whatever taxes would have been payable had they been owned by the decedent. But petitioner does not seek to carry its contention to such a conclusion. Having enjoyed the benefits which resulted from its separate existence, it seeks to perpetuate those benefits and asks that the separate existence and tax liability of the

petitioner and its single stockholder be overlooked only with respect to transactions which take place between them. That this is an afterthought is plainly evidenced by the action of petitioner in claiming a deduction upon this same transaction when it believed a deductible loss had been sustained.

23 Stress is laid upon the purpose for which petitioner was created. It seems to us immaterial whether the purpose was to avoid inheritance and transfer taxes or to permit the entire estate of decedent to stand as security for the endowment of the Charity in which decedent was interested. "What was done, rather than the design and purpose of the participants, should be the test." United States v. Phellis, 257 U. S. 156. If we are mistaken and the purpose is of importance, it may be pertinent to note that this second purpose had been entirely avoided by the time the transaction with which we are dealing took place. The trustees of the estate had convinced the trustees of the Charity that mortgage bonds were as desirable as the debenture bonds issued by petitioner and the Charity had exchanged such debentures. Neither of the purposes mentioned above justified the continued separate existence of petitioner at the time the stock here in question was sold and some other reason must have existed for its continuance. As we have said before, the reason seems immaterial. The fact is that petitioner did have a separate legal existence with privileges and obligations entirely separate from those of its stockholders. The fact that it had only one stockholder seems of no legal significance. Cannon Mfg. Co. v. Cudahy Co., 267 U. S. 333.

Under the facts set forth in our findings of fact we are asked to look through the form to the substance, to disregard the corporate entity, and to hold that the estate was in fact the owner of the stock of the British-American Tobacco Company. In support of this contention petitioner relies upon Southern Pacific Company v. Lowe, 247 U. S. 330, and Gulf Oil Corporation v. Lewellyn, 248 U. S. 71. In these cases the Supreme Court held that taxable income did not result from what they termed in the first case a "paper" and in the second case a "bookkeeping" transaction. Here we have

24 no mere bookkeeping or paper transaction, but the actual transfer of securities and the payment of a debt. The situation is not unlike those presented in United States v. Phellis, supra, and Rockefeller v. United States, 257 U. S. 176. In each of those cases it was held that stockholders of a corporation received taxable income, although after the transaction the stockholders held the same equities in the same properties as before. In the instant case the petitioner may have been no richer after the transaction than before, but the same is true of every transaction in which one sells property for its then value. It is because one sells property for more than its cost that a taxable gain results. Here petitioner sold property for more than its cost and after the transaction it had something different from that which it had before. That the transaction was with the estate which owned all its capital stock is not

material unless we are not to regard the separate entities of a corporation and its stockholders in transactions between them. That such is not the law seems settled by the cases cited.

Petitioner cites decisions which it is said disregard the separate entities where necessary to prevent fraud or injustice. Rubay Company, 9 B. T. A. 133; Franklin O. Brown, 9 B. T. A. 965. An analysis of those cases will, we believe, disclose that separate entities were not disregarded. In each of those cases the form of the transaction was not representative of the result accomplished and effect was given to the true situation and not to that depicted by form. Here there is no such case. Securities were sold at their market value and payment received. The form which the transaction took truly represents the transaction which took place.

The contention that the estate was neither richer nor poorer because of this transaction by reason of the ownership of the stock of petitioner is not new. It has been advanced in different forms to meet different states of facts. Thus, it has been asserted that
25 where upon the dissolution of a corporation the stockholders received its assets in proportion to their stockholdings, no income was realized for the reason that the stockholders were at all times the owners of the assets and thus no richer in the evening than they were in the morning of the day the transaction occurred. This contention was denied in E. C. Huffman, supra; John K. Greenwood, supra; Estate of D. F. Buchmiller, 1 B. T. A. 380; J. H. Morrow, Administrator, 1 B. T. A. 1148, and Joseph Joseph et al., 6 B. T. A. 595.

Although the state owned all of petitioner's stock, the transfers involved were made upon the basis of the true value of the securities exchanged and the debt extinguished, and therefore the bona fides of the transaction is not challenged. Neither does this transaction constitute a capital contribution by the estate to petitioner. The estate and petitioner each received full value. The gain of petitioner arises from the sale and exchange of capital assets, and is therefore taxable income, as defined in Eisner v. Macomber, 252 U. S. 189. See Nixon v. Lucas, Fed. (2d) , (C. C. A. 2d, July 7, 1930).

Reviewed by the board.

Decision will be entered for the respondent.

26 Before U. S. Board of Tax Appeals

Decision

Filed October 9, 1930

Pursuant to the board's findings of fact and opinion, promulgated October 8, 1930, it is

Ordered and decided that there is a deficiency for the year 1920 in the amount of $294,388.42.

(Sgd.) PERCY W. PHILLIPS,
Member United States Board of Tax Appeals.

In United States Circuit Court of Appeals

Petition for review of decision of United States Board of Tax Appeals

Filed April 6, 1931

To the Honorable the Judges of the United States Circuit Court of Appeals for the Third Circuit:

Your petitioner on review, Commonwealth Improvement Company, by its attorney, William R. Spofford, in support of this its petition filed in pursuance of section 1001 of the act of Congress approved February 26, 1926, entitled the "Revenue act of 1926" (44 Stat. 9), for review of the decision of the United States Board of Tax Appeals rendered on October 8, 1930, and the order entered on October 9, 1930, determining a deficiency in income and profits taxes for the calendar year 1920 in the amount of $294,388.42, respectfully shows:

Your petitioner on review is a corporation organized and existing under the laws of the Commonwealth of Pennsylvania, with its principal office at 405 Land Title Building, Philadelphia, Pennsylvania.

The respondent on review is the duly appointed, qualified,
27 and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States.

STATEMENT OF THE NATURE OF THE CONTROVERSY

1. The Commissioner of Internal Revenue determined a deficiency in income and profits taxes for the calendar year 1920 in the amount of $294,388.42, and on January 13, 1927, in accordance with the provisions of section 274 of the revenue act of 1926, mailed a notice of said deficiency to the petitioner. On March 5, 1927, the petitioner filed with the United States Board of Tax Appeals a petition for a redetermination of the deficiency in income and profits taxes for the calendar year 1920 determined by the commissioner. Thereafter, in due course, the commissioner filed his answer to the petition. On October 7, 1929, which date is subsequent to the enactment of the revenue act of 1926, the cause duly came on for hearing before the Board of Tax Appeals, at which time petitioner offered oral testimony and documentary evidence in support of the allegations contained in the petition, and respondent offered no testimony.

2. The question for determination by the Board of Tax Appeals was whether or not under the circumstances of this particular case petitioner realized a taxable profit upon the transfer of certain shares of stock to its sole stockholder in 1920.

3. In 1920 petitioner owned 225,000 shares of British-American Tobacco Company stock acquired in 1912 at a cost of $3,966,002. The March 1, 1913, value was $23⅝ per share, or a total of $5,315,625.

In 1919 petitioner acquired 75,000 shares of the same stock by the exercise of subscription rights at a price of $326,437.50.

28 4. In 1920 all petitioner's outstanding stock, having an aggregate par value of $2,000,000, and all petitioner's outstanding bonds, consisting of debentures having an aggregate face value of $4,000,000, were owned by the estate of P. A. B. Widener.

5. Petitioner transferred 225,000 shares of British-American Tobacco stock to its sole stockholder in exchange for the surrender of $4,000,000 (all) of its debentures, sundry stocks valued at $299,287.78, and the creation of a book credit in favor of the petitioner amounting to $737,794.44, making a total consideration passing to petitioner of $5,287,500.

6. Under regulations of the Commissioner of Internal Revenue then in effect, and not changed until October 18, 1922, more than two years after the instant transaction was consummated, no profit was recognized on the transaction, as the identical shares held in 1913 were delivered in 1920 for a consideration slightly less than the 1913 value. By Treasury Decision 3402 the Commissioner of Internal Revenue changed his regulations and required taxpayers to determine an average cost per share for the stock first acquired and the stock acquired by subscription. Averaging the cost of 225,000 shares held on March 1, 1913, and 75,000 acquired in 1919 resulted in an adjusted average cost of $18.80 per share for the British-American Tobacco Company stock, or a total cost on this basis of $4,231,546.88 for 225,000 shares, on which respondent computed a taxable profit of $1,055,953.12.

7. Petitioner contended in the trial before the Board of Tax Appeals (a) that petitioner and the estate of P. A. B. Widener were one and the same entity, and neither gain nor loss could result from transactions between them, and (b) that the March 1, 1913,

29 value of the identical shares as a basis for determining gain or loss should not be affected or decreased by the exercise of stock rights at a subsequent date.

8. In support of its contentions, petitioner produced evidence before the Board of Tax Appeals to show the corporate and financial history of petitioner, the reason for its existence, its functions and the inseparability of petitioner and the estate of P. A. B. Widener, all of which appears in detail in the record, with the exception of certain evidence which was rejected and which rejections are the basis for assignments of error. Petitioner also produced evidence to show the purpose and real nature of the transaction under consideration.

9. On October 8, 1930, the Board of Tax Appeals rendered its findings of fact, together with an opinion, in which it denied both of petitioner's contentions and held that petitioner had realized a profit of $1,055,953.12 on the transaction. On October 8, 1930, a final order of redetermination was entered by the Board of Tax Ap-

peals approving the deficiency of $294,388.42 determined by the respondent.

DESIGNATION OF COURT OF REVIEW

Your petitioner, a Pennsylvania corporation, with its principal office in Philadelphia, duly filed its income and profits tax return for the calendar year 1920 with the collector of internal revenue for the first district of Pennsylvania at Philadelphia, Pennsylvania. Petitioner desires a review of the decision of the Board of Tax Appeals by the United States Circuit Court of Appeals for the Third Circuit.

ASSIGNMENTS OF ERROR

Your petitioner says that in the record and proceedings be-
30 fore the Board of Tax Appeals, and in the decision and final order of redetermination rendered and entered by the Board of Tax Appeals, manifest error occurred and intervened to the prejudice of your petitioner, and your petitioner hereby assigns the following errors, and each of them which it is averred occurred in the said record, proceedings, decision and final order of redetermination, and upon which it relies to reverse the said decision and final order of redetermination so rendered and entered by the Board of Tax Appeals, to wit:

1. The Board of Tax Appeals erred in holding that the petitioner realized a taxable profit of $1,055,953.12 from the disposition of 225,000 shares of British-American Tobacco Company stock which were transferred to its sole stockholder, the estate of P. A. B. Widener, deceased, in 1920.

2. The Board of Tax Appeals erred in not finding as a fact that the estate of P. A. B. Widener and the petitioner are one and the same.

3. The Board of Tax Appeals erred in not holding that neither gain nor loss results from transactions between the petitioner and the estate of P. A. B. Widener.

4. The Board of Tax Appeals erred in rejecting petitioner's offer to prove by the witness Ballard that in 1917 a profit of some $130,000 shown on paper as a result of the recapitalization Mr. Ballard described was conceded by the commissioner to be nontaxable, because the Commonwealth Improvement Company (petitioner) and the estate of P. A. B. Widener were identical.

5. The Board of Tax Appeals erred in rejecting petitioner's offer of proof as follows:

31 "I offer in evidence petitioner's Exhibit No. 2, report of the revenue agent dated June 29, 1921, with respect to the income tax for the year 1919, of the estate of P. A. B. Widener. This report shows that in that year the estate of P. A. B. Widener sustained a loss in transactions between it and the Commonwealth Im-

provement Company amounting to $167,883.59, and that such loss was denied to the estate of P. A. B. Widener for the reason that the estate of P. A. B. Widener and the Commonwealth Improvement Company (petitioner) were identical, and that a profit made by petitioner for the year 1917 had been held by the commissioner to be a nontaxable profit."

6. The Board of Tax Appeals erred in rejecting petitioner's offer of proof as follows:

"I offer in evidence as petitioner's Exhibit No. 3, certificate of overassessment 905088, issued to P. A. B. Widener, second, Joseph E. Widener, George D. Widener, executors and trustees of the estate of P. A. B. Widener, such certificate being for the year 1919, and being offered to show that action proposed in the revenue agent's report offered as petitioner's Exhibit No. 2 was affirmed by the commissioner."

7. The Board of Tax Appeals erred in not finding as a fact that it was not an essential part of the transaction between petitioner and its sole stockholder that 225,000 shares of British-American Tobacco Company stock should be transferred at $23.50 per share, and petitioner would have been willing to make the transfer to its sole stockholder at a lower price.

8. The Board of Tax Appeals erred in not finding as a fact that when Joseph E. Widener decided to make the exchange of real estate mortgages for debentures, consummation of the transaction was put in Mr. Ballard's hands and he selected the British-American Tobacco shares with which to make the transfer, because
32 this block of stock had remained unchanged from the date it was originally delivered by P. A. B. Widener and its value at that time (1920 was within one-eighth of the value on March 1, 1913, and he might have well selected a security which would have shown a greater paper profit, or a loss.

9. The Board of Tax Appeals erred in not finding as a fact that the details of the transaction involving the substitution of securities as an endowment for the charity and the transfer of 225,000 shares of British-American Tobacco Company stock were not discussed at any formal meeting of the directors of petitioner.

10. The Board of Tax Appeals erred in holding that the March 1, 1913, value of 225,000 shares of British-American Tobacco Company stock, to wit, $23⅝ per share, or $5,315,625, held by petitioner on that date should be decreased by reason of petitioner's exercise of stock rights in 1919, and the acquisition of 75,000 shares thereby at a cost of $326,437.50.

11. The Board of Tax Appeals erred in entering judgment for the respondent.

Wherefore your petitioner prays that the United States Circuit Court of Appeals for the Third Circuit may review said decision, opinion, and order of the United States Board of Tax Appeals, and

reverse and set aside the same, and enter an order directing the said Board of Tax Appeals to enter judgment of no deficiency for the petitioner, and your petitioner will ever pray.

(Sgd.) WM. R. SPOFFORD,
Attorney for Petitioner on Review,
1035 Land Title Building, Philadelphia, Pa.

33 [*Duly sworn to by Wm. R. Spofford; jurat omitted in printing.*]

34 Before United States Board of Tax Appeals

Docket No. 24959

COMMONWEALTH IMPROVEMENT COMPANY, PETITIONER ON REVIEW

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT ON REVIEW

Statement of evidence

Filed May 19, 1931

The above-entitled cause came on for hearing before the Honorable Percy W. Phillips, member of the United States Board of Tax Appeals, on October 8, 1929. William R. Spofford, Esquire; Schofield Andrews, Esquire; and Ellis Ames Ballard, Esquire, appeared for Commonwealth Improvement Company, the taxpayer and petitioner before the Board of Tax Appeals, and John D. Foley, Esquire, for C. M. Charest, general counsel, Bureau of Internal Revenue, appeared for the Commissioner of Internal Revenue.

Thereupon, ELLIS AMES BALLARD, secretary and treasurer of the petitioner, having been called as a witness and having first been duly sworn, gave the following testimony:

My name is Ellis Ames Ballard. My address is City Line, Roxborough, Philadelphia, Pennsylvania. My occupation is attorney at law. I have been secretary and treasurer of the Common-
35 wealth Improvement Company since May 1, 1912. I was counsel for P. A. B. Widener up to his death in 1915 and have been counsel for his estate since his death. The Commonwealth Improvement Company has what in Pennsylvania is called a special charter granted prior to the adoption of the constitution of 1874. Since that date Pennsylvania corporations are limited to one specific object. Prior to that date the legislature granted to applicants what were called special omnibus charters, under which you could do almost anything, as you can to-day under a Delaware charter. The Commonwealth Improvement Company has one of those charters.

In 1911 the Supreme Court decreed the dissolution of the Standard Oil Company and the American Tobacco Company, in each of which P. A. B. Widener was a large stockholder, and as a result there came into his hands perhaps $20,000,000 worth of stock of corporations incorporated in many of the different States and in England, the latter being the place of incorporation of the British-American Tobacco Company, which is the stock that is specifically before you here. Mr. Widener was an old man and his affairs were attended to by his son, George D. Widener. I advised him, in order to avoid extraterritorial death duties, to put all his father's non-Pennsylvania securities into a Pennsylvania corporation if we could find an old charter available. He told me to find such an old charter, and I bought for Mr. Widener all the shares of the Commonwealth Improvement Company. He then suggested I talk with his father and see if I could get him to incorporate himself with respect to all his non-Pennsylvania holdings. It was a rather delicate subject, as he was an old man, perhaps 80, suggesting to him that when he died, which must be soon, he could save a very substantial sum in taxes which would be payable to jurisdictions to which I felt he owed no duty, such as Kansas, Oklahoma, California, and
36 Great Britain. He declined to do it. He said that there was enough money to pay the taxes and he would not do it. George D. Widener, under whose directions I had taken these steps, was lost on the "Titanic" on April 12, 1912. In the meantime P. A. B. Widener had bought a large tract of land in Philadelphia and built the Widener Memorial School for Crippled Children, at an expense of $3,000,000 or $4,000,000. He sent for me after George's death and said that he had no one now to look after his affairs; that he was anxious to create the safest endowment that he could for the school; and if I followed the plan which I had outlined to him several months before, could a lien be placed upon his whole fortune as an endowment for the school. He wanted $4,000,000 for this purpose and might later want to raise it to $5,000,000.

I told him that while there could not be a lien there could be a debenture issue which would be a first claim against the corporation. We do not have liens on personal property in Pennsylvania. I advised him to take up this charter and to put into the company all his non-Pennsylvania securities. He told me to go ahead and do it. I increased the capital of this company and provided for two issues of debentures. I made a list of all his non-Pennsylvania securities, putting upon them the then current market price, and we reorganized the company, which was an old company then out of business, with a capital of $5,000,000, all owned by P. A. B. Widener, with script of $5,000,000 convertible into capital stock at the option of the corporation, all owned by P. A. B. Widener, with an issue of 4 per cent first debentures of $5,000,000, all owned by P. A. B. Widener, and an issue of $10,000,000 6 per cent debentures, all owned by P. A. B. Widener ($25,000,000), and transferred into the name

of Commonwealth Improvement Company every share of stock owned by P. A. B. Widener issued by other than Pennsylvania corporations, with one exception. Mr. Widener was a director
37 of the United States Steel Company. He had to be a stockholder and one share of United States Steel preferred was left in his name, which I think is there yet. This transfer was effected May 1, 1912.

Mr. Widener died in 1915. His estate consisted of securities in Pennsylvania corporations, a little real estate, his collection of pictures, which eventually will go to the city of Philadelphia, and his interest in non-Pennsylvania corporations, all of which he held in the name of the Commonwealth Improvement Company. The directors and officers of that company were his surviving son, Joseph E. Widener, his surviving grandson, George D. Widener, who was the son of George D. Widener, who had perished on the "Titanic," and myself. Qualifying shares were in their names. These were indorsed and delivered to Mr. Widener, and there has been no transfer of stock from that date, May 1, 1912, to the present time. Every share of stock and every bond that was issued belonged to Mr. Widener. A deed of trust was drawn, and four million of the five million first 4 per cent debentures were delivered to the Land Title & Trust Company in Philadelphia, to hold the same in perpetuity as an endowment for the Widener Memorial School for Crippled Children. The deed of trust and delivery of those securities was effected immediately after May 1, 1912. The executors and trustees under the will of P. A. B. Widener are his son, Joseph E. Widener, and his grandson, George D. Widener. In 1915, and subsequently through the year 1920, I was counsel for the estate of P. A. B. Widener, but my compensation came to me as secretary-treasurer of the Commonwealth Improvement Company, through a salary of $20,000 a year, which I have drawn since 1912. Since 1920, when I formed a partnership, my salary has always been included as a fee in my office and divided under our partnership articles. Trustees of the estate
38 of P. A. B. Widener have not received commissions from the estate since their appointment to date, but each of them draws a salary of $25,000 as an officer of the Commonwealth Improvement Company. The clerks and bookkeepers employed in keeping the books of the estate of P. A. B. Widener were paid by the Commonwealth Improvement Company during 1920. All expenses of the office used by the estate of P. A. B. Widener are expenses of the Commonwealth Improvement Company, and the lease is in the latter's name. Commencing with the time of P. A. B. Widener's death in 1915, there were from time to time transactions between the estate of P. A. B. Widener and the Commonwealth Improvement Company. The general nature of the transactions was that as either part of the estate was in funds it might advance them to the other hand of the estate, or if it was desirable to have stock to sell, or perhaps to hypothecate, and it seemed more desirable to have it in the

names of the trustees of the estate than in the Commonwealth Improvement Company, transfers would be made and proper book entries would evidence that fact.

Two years after P. A. B. Widener's death we reduced the capital structure of the Commonwealth Improvement Company to $2,000,000 of stock and $4,000,000 of bonds, being the bonds deposited with the trustees for the Charity. We cancelled $10,000,000 of bonds (6 per cent debentures), $1,000,000 of bonds (4 per cent debentures), $3,000,000 of stock, and $5,000,000 of script, by transferring from the name of the Commonwealth Improvement Company to the name of the trustees securities equal in value to the securities of the Commonwealth Improvement Company cancelled. If there was any difference it was a charge entry.

Q. Do you recall, being treasurer of the Commonwealth Improvement Company, whether or not as a result of that transaction in 1917 it was claimed any time that the Commonwealth Improvement Company had incurred a liability for income tax because thereof?

39 Mr. FOLEY. I object to that as incompetent, irrelevant, and immaterial.

The MEMBER. Objection sustained.

Mr. ANDREWS. While I do not wish to show the commissioner at any time conceded the identity of the estate and the company and that a paper profit was not a taxable profit, I do not wish to show that to take the position that there is a technical legal estoppel now upon the commissioner to take a different attitude as respects the year 1920, nevertheless in a case like this, in which we have asked the board to look through the form and see the substance, any evidence showing a recognition of the identity is evidence which is relevant and material to the principal issue.

I can prove by this witness that in 1917 the commissioner conceded that a profit of some $130,000 shown on paper as a result of the recapitalization Mr. Ballard described was conceded by the commissioner to be nontaxable because the Commonwealth Improvement Company and the estate were identical.

The MEMBER. I think the objection to such testimony is well taken and will stand.

Mr. ANDREWS. Exception.

The MEMBER. Yes.

In 1920 Mr. Joseph E. Widener stated that they now had real-estate mortgages secured on the best property in Philadelphia which he would like to substitute as an endowment for the Widener Memorial School in place of the debenture bonds. About the time of Mr. Widener's death he had bought, or immediately after his death his son had bought, I am not sure which, the property on

40 which the Ritz-Carlton now stands in Philadelphia, at Broad and Walnut, and the old property on which the United States Mint stood on Chestnut Street and Juniper, next to the Wanamaker

store. Both of these properties are a short block from Broad and Chestnut, which is the center of Philadelphia real estate, and in 1920 mortgages secured thereon were in the hands of the estate.

The trustees of the estate exchanged the mortgages which they held with the trustees for the Charity for the four millions of debentures. Four millions of debentures were then held by that part of the estate which was unincorporated. They were claims against the part of the estate which was incorporated. The 1920 price of the British-American Tobacco stock was practically identical with the March, 1913, price, and as the identical 225,000 shares which had been delivered by Mr. Widener in 1912 to the Commonwealth Improvement Company as part of the consideration for the issue to him of all its stocks and bonds were held by the Commonwealth Improvement Company, the exchange was made. There were other entries on the books which you have described in your statement which were cleaned off at that time as being entries between two parts of the same entity, and the balance as shown by the figures used was set up as a debit and a credit between one and the other.

The four millions of Commonwealth Improvement Company debentures were surrendered by the trustees of the Widener estate to the Commonwealth Improvement Company as a part of this settlement. Mr. Widener and I went down to the basement and threw the debentures into the furnace.

Q. Mr. Ballard, was it an essential part of this transaction that the 225,000 shares of British-American Tobacco be transferred to the estate at $23.50 per share?

A. No.

41 Q. Would the Commonwealth Improvement Company have been willing to make that transfer at a lower price?

A. Yes.

Mr. FOLEY. I object to that as irrelevant and immaterial.

The MEMBER. Objection overruled.

Mr. FOLEY. Exception.

Mr. ANDREWS. Mr. Ballard, Mr. Widener having decided to make this exchange of real mortgages for debentures, in whose hands was the carrying through of the transaction placed?

A. Placed in mine.

Q. Will you describe again how it happened you gave the transaction exactly this form, namely, a transfer of British-American Tobacco shares?

A. This was a block of stock which had remained unchanged from the date it was delivered by Mr. Widener. It was the block of stock which has the same price or within one-eighth or one-fourth of it, of the March 1, 1913, price, and it seemed to be the line of the least resistance. I might well have selected a security which would have shown a greater paper profit, or a security which might have shown a loss.

Q. Was it left to your judgment in expressing this transfer on the books to pick the securities to be transferred and the transfer price to be expressed in the books?

A. It was certainly left to my judgment, with the bookkeeper and the broker to find out what the current price was. I would not have selected the securities without consulting with Mr. Widener, which I doubtless did.

At $23.50 per share 225,000 shares of British-American
42 Tobacco Company stock aggregate $5,287,500. The debentures to be cancelled had a face value of $4,000,000, and the Widener estate had a book account against the Commonwealth Improvement Company of $250,417.78, so that on the one hand, the estate had claims against the company aggregating $4,250,417.78 and the express transfer consideration of the shares of the British-American Tobacco Company was $5,287,500, leaving a considerable balance in favor of the Commonwealth Improvement Company. As a matter of bookkeeping the balance was set up as a debit and credit on the books, both the estate's side and the corporation's side of the estate. I recall that after these transfers were made there was a very considerable balance owed by the estate to the company and as both the estate's books and the company's books were accurately kept by accountants, those differences would be shown. You can go back over these years and you will find that at times the balance is on one side and at times the balance is on the other side.

I am a director of corporations other than the Commonwealth Improvement Company.

After Joseph E. Widener told me that he wanted to make the substitution of securities as an endowment for the Charity, I went ahead and I did it. I wrote up the transaction on the minutes, which were approved by the other directors, and George Mantz, who was the bookkeeper, made the bookkeeping entries.

Q. Do you recall whether or not the details of the transactions were discussed in a formal meeting of the directors of the Commonwealth Improvement Company?

A. They never were.

Since 1912 the stockholders' meetings of the petitioner have been held in the following manner. Every year I have received proxies from the stockholders of record. I have held the meeting in my office, filed the proxies, and have written up the minutes. So
43 far as directors' meetings are concerned, Mr. Widener would come in to see me or ask me to come down to his office and would say, "I want to do so and so"; he would then call in George, his nephew, and later I would write up the minutes and consummate the transaction. There never has been a meeting of either stockholders or directors of the Commonwealth Improvement Company at which the stockholders or directors sat around a table and made motions and passed resolutions in the ordinary sense.

Thereupon counsel for petitioner offered in evidence as petitioner's Exhibit No. 1, copy of the will of P. A. B. Widener, dated July 13, 1912. This was received in evidence over the objection of counsel for the respondent and an exception was granted. No error has been assigned which in any way relates to the contents of the will to the findings made therefrom. Accordingly, petitioner's Exhibit No. 1 is not printed as part of this record.

Thereupon the following colloquy took place between petitioner's counsel and the presiding member of the board:

Mr. ANDREWS. Your honor, you will recall the objection made by Mr. Foley to the offer to show by Mr. Ballard that in 1917 the Commissioner of Internal Revenue had ruled that a paper profit was not a taxable profit. In order that there may be no misunderstanding, I understand your honor's ruling was to the effect that such testimony was not relevant or material and not bearing on Mr. Ballard's competency to testify.

The MEMBER. That is correct.

Mr. Ellis Ames Ballard testified on cross-examination as follows:

44 In stating in my direct examination that the 1920 price of the British-American Tobacco Company stock was identical with the 1913 price, I was not considering the issuance of stock rights and the exercise of those rights. I said "identical," but there may have been a fractional difference; it was practically identical.

The stock of the Commonwealth Improvement Company was not acquired by Mr. Widener for the purpose of having some agency or some medium for holding non-Pennsylvania stocks in order to avoid death duties in case of his death. I presented that phase of the situation to him as his counsel, at the suggestion of his son, George, several months before, but he turned it down. Later on he said that he wanted to create the best security he could as an endowment. If I could do this and make it a lien or a claim against the bulk of his estate, he would do it. That is exactly what happened. He agreed that the property to be transferred to the Commonwealth Improvement Company should be the non-Pennsylvania stocks which he had. At the time of P. A. B. Widener's death Commonwealth Improvement Company held all his non-Pennsylvania stocks except one share of United States Steel preferred, which was simply a qualifying share. As the result of this holding of the non-Pennsylvania stocks, his estate was able to avoid death duties to the States or countries in which these non-Pennsylvania corporations had been incorporated. In Pennsylvania stocks of non-Pennsylvania corporations, in the hands of an individual, are taxed at the rate of four mills, but in the hands of a corporation they are taxed at the rate of five mills, so that from 1912 on the Pennsylvania tax has always been one-fourth greater. That tax was paid to the State to which he owed fealty and not to Oklahoma. I believe that at that time the Oklahoma tax act was so drawn that if an estate

over one and a quarter million dollars was left the tax would exceed 100 per cent.

45 Q. The thing I wanted to bring out, Mr. Ballard, was that the use of the Commonwealth Improvement Company as a medium for holding non-Pennsylvania stocks was productive of the purpose for which it was used, that is, you avoided death duties in other States and countries.

A. As a lawyer I thought this plan up and advised it. My advise was turned down.

Mr. FOLEY. Read the question.

(The pending question was thereupon read by the reporter as above recorded.)

The WITNESS. The answer to that question as you have framed it is no. It was productive for the purpose for which it was used, Mr. Widener's purpose, that he placed as nearly as you can place in Pennsylvania a $4,000,000 lien upon the bulk of his estate, but his purpose was not at any time to avoid these taxes. My own was. That is perfectly true.

Since these non-Pennsylvania stocks were at the time of Mr. Widener's death held by the Commonwealth Improvement Company the estate of P. A. B. Widener paid no estate or inheritance taxes to States other than Pennsylvania on those stocks. At the time of Mr. Widener's death it did not occur to me to contend or to say, rather, to the inheritance tax authorities in these various States that Mr. Widener really owned these non-Pennsylvania stocks, and that the Commonwealth Improvement Company was just a name.

The witness was thereupon excused.

Counsel for petitioner thereupon made the following offer of proof:

Offers in evidence

Mr. ANDREWS. I offer in evidence petitioner's Exhibit No. 2, report of the revenue agent dated June 29, 1921, with respect

46 to the income tax for the year 1919, of the estate of P. A. B. Widener. This report shows that in that year the estate of P. A. B. Widener sustained a loss in transactions between it and the Commonwealth Improvement Company amounting to $167,883.59, and that such loss was denied for the estate of P. A. B. Widener for the reason that the estate of P. A. B. Widener and the Commonwealth Improvement Company were identical, and that a profit made by petitioner for the year 1917 had been held by the commissioner to be a nontaxable profit.

Mr. FOLEY. I object to it on the ground the evidence tendered is irrelevant and immaterial.

The MEMBER. Objection sustained.

Mr. ANDREWS. Exception.

The document offered as petitioner's Exhibit No. 2 consists of seven pages of closely typewritten matter, most of which is not essential to this case. The essential provisions relate to the disallowance of a loss to the estate of P. A. B. Widener in 1919 and the reasons therefor, and are as follows:

"Block C. Original, Form 1041, loss on sale of securities $167,883.59 to the Commonwealth Improvement Company, has been eliminated entirely for the following reason:

"The above-named company acts as a holding company of securities for the P. A. B. Widener estate, the estate owning every share of stock in the corporation.

"The estate and corporation for convenience make a practice of transferring securities to each other.

"In 1917 securities were transferred from the company to the estate at a profit of $131,000, which the trustees objected to being considered as a profit, stating it was simply a transfer.

47 "For details pertaining to this transaction see report of Agents Graves and Mills, dated November 13th, 1918.

"The above agents accepted the explanation given for the 1917 transfer and did not include the $131,000 as taxable income."

Petitioner's counsel thereupon made the following offer of proof:

I offer in evidence, as petitioner's Exhibit No. 3, certificate of overassessment 905088, issued to P. A. B. Widener, second, Joseph E. Widener, George D. Widener, executors and trustees of the estate of P. A. B. Widener, such certificate being for the year 1919, and being offered to show that action proposed in the revenue agent's report offered as petitioner's Exhibit No. 2 was affirmed by the commissioner.

Mr. FOLEY. The same objection.

The MEMBER. Objection sustained and exception noted and allowed.

For the purpose of preserving the record it might be well to mark those for identification petitioner's Exhibits No. 2 and 3. (Said documents so marked.)

The document offered as petitioner's Exhibit No. 3 consists of a printed form used by the Commissioner of Internal Revenue entitled "Certificate of overassessment," for the purpose of showing his final disposition of overassessments determined in the examination of income tax returns of a taxpayer. The document contains the following language:

"The report of the revenue agent in Philadelphia, Pennsylvania, dated June 29, 1921, has been reviewed and approved."

The certificate of overassessment further discloses the fact that
48 the overassessment which had been approved by the Commissioner of Internal Revenue was allowed as a credit in settlement of other outstanding tax liabilities.

Counsel for petitioner and counsel for respondent stipulated that the cost of 225,000 shares of British-American Tobacco Company

stock to Commonwealth Improvement Company in 1912 was $3,966,002.

The foregoing evidence is all the material evidence adduced at the hearing and the same is approved by the undersigned as attorney for Commonwealth Improvement Company.

(Sgd.) WM. R. SPOFFORD.

The above statement of the evidence is agreed to by C. M. Charest, general counsel, Bureau of Internal Revenue, as attorney for the Commissioner of Internal Revenue.

(Sgd.) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

49 Before U. S. Board of Tax Appeals

Præcipe for record

Filed May 6, 1931

To the clerk of the United States Board of Tax Appeals:

You will please prepare and, within sixty days or within such time as extended by order of the board from the date of the filing of the petition for review in the above-stated cause, transmit to the clerk of the United States Circuit Court of Appeals for the Third Circuit certified copies of the following documents:

1. The docket entries of proceedings before the United States Board of Tax Appeals in the above-entitled case.
2. All pleadings before the board.
3. Findings of fact, opinion, and decision of the board and its order of redetermination, dated October 9, 1930.
4. Petition for review.
5. Statement of the evidence settled or agreed upon.

The certified copies of the foregoing documents are to be prepared and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Third Circuit.

Dated this sixth day of May, 1931.

(Sgd.) WM. R. SPOFFORD,
Attorney for Petitioner on Review.

50 [Clerk's certificate to foregoing transcript omitted in printing.]

51 In United States Circuit Court of Appeals for the Third Circuit

No. 4639 (List No. 27). October term, 1931

COMMONWEALTH IMPROVEMENT CO., PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the U. S. Board of Tax Appeals

Order assigning judges

Filed Oct. 16, 1931

And now, to wit, this sixteenth day of October, A. D. 1931, it is ordered that Hon. Albert W. Johnson, district judge, for the Middle District of Pennsylvania, and Hon. ———, district judge for the ——— District of ———, be, and he is hereby assigned to sit in above case in order to make a full court.

VICTOR B. WOOLLEY,
Circuit Judge.

[File endorsement omitted.]
[Minute entry of argument and submission, Oct. 16, 1931, omitted in printing.]

52 In United States Circuit Court of Appeals for the Third Circuit

No. 4639. October term, 1931

COMMONWEALTH IMPROVEMENT COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for review from the United States Board of Tax Appeals

Opinion

Filed March 17, 1932

Before WOOLLEY and DAVIS, Circuit Judges, and JOHNSON, District Judge

DAVIS, Circuit Judge.

This petition for review concerns income and excess profits taxes for the year 1920. The extraordinary situation here arises out of the relation of the taxpayer to the estate of P. A. B. Widener.

In 1912, Mr. Widener, desiring to place a lien on his fortune to insure an endowment to the Widener Memorial School for Crippled Children, which was his favored charity, transferred all of his stocks and securities, except those of Pennsylvania corporations, to the taxpayer, Commonwealth Improvement Company, a Pennsylvania corporation, whose charter he had purchased for this purpose. In return, the taxpayer issued and transferred to Mr. Widener all of its stock and bonds, aggregating a par value of $25,000,000.

Mr. Widener executed a deed of trust, and delivered to the trustee $4,000,000 of the taxpayer's bonds to be held as a perpetual endowment for the charity. Mr. Widener died three years thereafter, and as a consequence of the situation, whereby the taxpayer held all of his stocks and securities save those of Pennsylvania companies, the estate paid no death taxes to any State other than Pennsylvania.

After Mr. Widener's death the capital structure of the taxpayer was reduced to $2,000,000 in stock, and $4,000,000 of debentures, the latter being the same deposited with the trustee for the charity. The remainder of the stock and bonds was canceled and destroyed. The reduction of the capital structure was effected by transferring from the taxpayer to the trustee of the Widener estate securities equal in value to the stock and bonds canceled, any difference in value being entered on the books of each.

Among the stocks transferred to the taxpayer in 1912 were 225,000 shares of the British-American Tobacco Company, having on March 1, 1913, a value of $5,315,625, or $23.625 per share. In 1919 the British-American Tobacco Company gave the privilege to subscribe to one share of new stock at $4.3525 for every three shares
53 held by a stockholder. The taxpayer taking full advantage of its right, purchased 75,000 shares for $326,437.50.

In 1920 it was deemed advisable to substitute certain real estate bonds of the Widener estate for the $4,000,000 of debentures of the taxpayer which were held in trust for the charity. By this transaction, the estate again became the owner of the remaining outstanding debentures of the taxpayer.

And thus came about the unusual situation which brings us to the issue in this case. The trustees of the Widener estate owned the entire interest in the taxpayer, and completely dominated it. The following transaction was arranged: The taxpayer transferred 225,000 shares of the stock of the British-American Tobacco Company to the trustees of the estate in consideration of the estate surrendering the $4,000,000 of debenture bonds of the taxpayer (being the same bonds formerly held by the trustee for charity) and certain other transactions totaling $1,287,500. Hence the 225,000 shares of the British-American Tobacco Company were exchanged for $5,287,500, or $23.50 per share.

In its income-tax return for 1920 the taxpayer claimed as a loss the difference between the March 1, 1913, value of $5,315,625 for 225,000 shares and the amount of $5,287,500 realized by the exchange

with the Widener estate. But the Commissioner of Internal Revenue made the following adjustment in the March 1, 1913, value:

225,000 shares; March 1, 1913, value	$5, 315, 625. 00
75,000 shares; acquired on exercise of stock rights for	326, 437. 50
300,000 shares	5, 642, 062. 50
1 share	18. 803875
225,000 shares	4, 231, 566. 88

According to the determination of the commissioner, the exchange resulted in a profit of $1,055,953.12 instead of the loss claimed by the taxpayer, and a deficiency in income tax for 1920 of $294,388.42. The Board of Tax Appeals sustained the commissioner's decision. 20 B. T. A. 1189.

Section 213 (a) of the revenue act of 1918 provides that gross income includes gains, profits, and income derived from dealings in property. Here there has been an exchange of property resulting apparently in a large profit which would obviously be taxable. Section 202 (d) of the revenue act of 1918.

The taxpayer itself concedes that it and the estate are distinct beings in contemplation of the law and subject to the burdens thereof. But the taxpayer asks this court to deny the Government's right to tax gains, profits, or income that are illusory, and do not exist in fact.

By determining whether this court has the power to examine this exchange of property for its substance, we come to the ultimate questions in this case: (a) Is there any real gain or loss to be taxed? and (b) did Congress intend to tax that which is income in form only?

Counsel for the taxpayer have offered two cases, which they frankly admit do not control this case on its facts, to show that we may
54 examine the transaction here concerned for its substance as an incidence to income taxation. Southern Pacific Company v. Lowe, 247 U. S. 330; Gulf Oil Corporation v. Lewellyn, 248 U. S. 71.

In the Southern Pacific Company case, the plaintiff railway company owned all the stock of, and leased, a second railroad. The property and funds of the subsidiary company were in the possession of the plaintiff. In 1913 the plaintiff caused the subsidiary to declare a dividend on income accumulated prior to 1913, payment of which was effected by a credit to the plaintiff on its books. The Supreme Court held that the dividend was not subject to an income tax, as the income out of which it had been declared, although earnings accumulated prior to the effective date of the sixteenth amendment were taxable, under the peculiar facts of the case, had substantially accrued to the plaintiff before the declaration of the dividend. The principle of the case was extended to Gulf Oil Company v. Lewellyn, supra, wherein the holding corporation which received the dividend was the owner of all the stock of a subsidiary and engaged in a single enterprise, but was not the lessee and neither conducted the business nor was in possession of the funds of the subsidiary.

The point comes down to this: Did Congress intend that "income" should be used as a word of art or in a real and practical sense? In the Southern Pacific case, the Supreme Court said:

"We base our conclusion in the present case upon the view that it was the purpose and intent of Congress, while taxing 'the entire net income arising or accruing from all sources' during each year commencing with the first day of March, 1913, to refrain from taxing that which, in mere form only, bore the appearance of income accruing after that date, while in truth and in substance it accrued before; and upon the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and in other capacities."

The principle announced in those two cases of the Supreme Court controls this case. This court will examine the exchange of property between the taxpayer and the Widener estate to determine if it in fact produced income.

At the time of the exchange the regulations of the Treasury Department prescribed the value of March 1, 1913, of stock acquired prior to that time as the basis for determining profit or loss. Article 39, Regulations 45. But the regulations were amended in 1922 by T. D. 3206, and accordingly the commissioner ruled that the value of the stock must be reduced proportionally by the quotient basis because the taxpayer had acquired 75,000 additional shares in 1919 by virtue of its stock rights. On paper, then, the commissioner determined that the taxpayer had made a large profit by the exchange.

55 The trustees of the Widener estate completely dominated the taxpayer. They owned and controlled it. The purpose, whatever it may have been, for the purchase of the taxpayer, had been served. In 1920 there seemed no longer to be any need for its existence, and so the trustees were evidently proceeding to wind up its affairs in an orderly fashion. Without question the transaction might have taken any form that the trustees desired.

No cash was exchanged for the stock. The taxpayer's assets had been materially reduced, and it was considered sound by the trustees to substitute other securities for the bonds of the taxpayer held by the Charity. Thus the estate obtained the bonds from the Charity, and to reduce further the taxpayer's capital structure the bonds were surrendered by the estate to the taxpayer and cancelled. Obviously, in actual dollars and cents, it made no difference to the estate itself whether or not they obtained anything in return; but in order to balance the books the block of British-American Tobacco stock was taken, as its then value was substantially the same as on March 1, 1913, and was the largest single block standing in the taxpayer's name.

The stock was transferred, and to offset the balance due the taxpayer on the exchange it was given credit on its books. The result

of the transaction produced no gain, nor loss, nor income to either the taxpayer or the Widener estate.

The Board of Tax Appeals was of the opinion that "the form which the transaction took truly represents the transaction which took place," that is, that the taxpayer actually received a profit of $1,055,953.12. But in this the board is mistaken. The profit resulting to the taxpayer is illusory and nonexistent. The law is interested in an income from which an economic benefit may be realized. The exchange resulted in a mere paper profit, and this was made possible only because the regulations were changed some two years after the transaction.

The estate owned the taxpayer, and was in control and possession of all of its property. In substance, the taxpayer in this case was a mere agent of the Widener estate, and did not realize any taxable profit from this transaction, and so the order of redetermination of the Board of Tax Appeals is reversed.

A true copy.

Teste:

Clerk of the United States Circuit Court of Appeals for the Third Circuit.

56 In United States Circuit Court of Appeals for the Third Circuit

No. 4639. October term, 1931

COMMONWEALTH IMPROVEMENT CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals

Judgment

Filed March 17, 1932

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this court that the order or decree of the said Board of Tax Appeals in this cause be, and the same is hereby, reversed.

Philadelphia, March 17, 1932.

J. WARREN DAVIS,
Circuit Judge.

[File indorsement omitted.]

[Clerk's certificate to foregoing transcript omitted in printing.]

57 Supreme Court of the United States

Order allowing certiorari

Filed May 31, 1932

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted, and the case is assigned for argument immediately following case No. 911, Dalton vs. Bowers, as executor.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Indorsement on cover:) File No. 36791. U. S. Circuit Court of Appeals, Third Circuit. Term No. 95. David Burnet, Commissioner of Internal Revenue, petitioner, vs. Commonwealth Improvement Company. Petition for a writ of certiorari and exhibit thereto. Filed May 20, 1932. File No. 36791.

U. S. GOVERNMENT PRINTING OFFICE: 1932